



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
MANAGEMENT DIVISION

DATE: August 6, 2001
To: Board of Governors
VIA: Stephen R. Malphrus and Vice Chairman Roger W. Ferguson, Jr.
FROM: Stephen J. Clark
SUBJECT: 2002–03 Budget Objective

ACTION REQUESTED

Approval of a 2002–03 operating budget objective of \$435.7 million, an increase of \$42.3 million (5.2 percent per year) over the 2000-01 base.

BACKGROUND

On a biennial basis, the Board's division directors and Committee on Board Affairs engage in a strategic planning and budgeting process. The strategic plan is prepared for the next four years and a budget is formulated to support planning outcomes for the next two years. For the 2002–05 planning period and 2002–03 budget period, the Committee on Board Affairs (CBA), assisted by a senior-level Staff Planning Group (SPG), guided the process. Division directors, working with their oversight committees, reviewed the operating environment, potential legislation, and other factors affecting division operations and considered changes to the mission, organization, and resources needed for the Board to carry out its missions efficiently and effectively. The planning and resulting resources will form the basis for the Board's 2002-03 budget.

The SPG reviewed the planning materials submitted by the Board's divisions and offices and identified the following major issues having Boardwide impact over the planning period:

- Attraction and retention of staff
- Board organization
- Information Technology
- Physical Plant
- External and internal factors

These issues are reflected in the resource decisions of the CBA that form the basis of the recommended budget objective. As a result, the planning and the resource decisions will also serve as the basis for the Biennial Performance Plan prepared as part of the Board's voluntary compliance with the Government Performance and Results Act.

DISCUSSION

Based on CBA guidance and SPG analysis, staff recommends an operating budget of \$435.7 million for 2002-03. This represents an increase of \$42.3 million over the 2000-01 base of \$393.4 million, a projected rate of growth of 5.2 percent per year.

In the planning process, the CBA considered new initiatives totaling \$14.1 million that were recommended by the various divisions and offices. Of these, the CBA endorsed initiatives totaling \$8.7 million. Of this amount, \$3.7 million is personnel costs (primarily variable pay and an increased cash award pool), and \$5.0 million is for goods and services (primarily data purchases, consulting services, facilities maintenance and enhancements, and improved relocation benefits.)

The CBA also reviewed current activities that could be scaled back or eliminated and identified \$17.0 million in savings for the upcoming budget period. Savings from anticipated management actions account for \$6.0 million. Staff reductions in areas affected by automation and the elimination of temporary increases to accommodate management succession plans account for \$4.6 million. Divisions have already identified \$2.3 million in reductions in response to a System initiative to reduce information technology costs; in addition, they are being asked to identify an additional \$2.6 million, an amount that the CBA suggested the directors consider taking from information technology and travel.

Personnel costs dominate the Board's budget and most of the increase falls in this category. Funding for merit increases represents the largest component (\$21.9 million, or 52 percent) of the increment in the budget objective. In developing the objective, we assumed a merit increase of 4.2 percent in 2002 and 4.0 percent in 2003. The Management Division will present a recommendation for the 2002 merit increase to the Board in October based on salary surveys now in progress. At that time the Board may wish to adjust the objective.

A variable pay program for economists was approved early this year. Funding for expansion of the program to include attorneys and official staff is included in the objective. These salary initiatives are expected to add \$5.5 million to the operating budget.

The cost of fringe benefits is expected to increase by \$7.2 million during the period. Of this amount, \$3.8 million results from rate increases, primarily for health insurance, and \$3.4 million results from increased Board contributions to the Thrift Plan and to Social Security.

The budget objective also reflects a projected increase of \$4.8 million in the cost of goods and services using the assumptions from the 2002 federal budget.

In summary, the budget is projected to rise by \$43.3 million. We have assumed a savings target of \$1.0 million over the course of the budget period to reduce the increase to \$42.3 million (5.2 percent per year) and recommend approval of this budget objective.